INDEPENDENT OIL TOOLS LTD v. DATO' RAMLI MD NOR & ORS

HIGH COURT MALAYA, KUALA LUMPUR
AZIZUL AZMI ADNAN J
[ORIGINATING SUMMONS NO: WA-24NCC-306-07-2017]
20 FEBRUARY 2018

COMPANY LAW: *Derivate action – Leave to commence derivative action – Application for – Parties entered into joint venture agreement – Majority shareholder of joint venture company owed money to joint venture company – Application filed by minority shareholder to recover sums due on unpaid invoices from majority shareholder – Whether directors received any notice that minority shareholder/applicant applied for leave of court – Whether there were defects in notification – Whether application made in good faith – Companies Act 2016, ss. 347 & 348*

The applicant and a company known as Olio Resources Sdn Bhd ('Olio') had entered into a joint venture agreement ('JVA') where the former held 30% of shares while the latter held the remaining and majority shares in the third respondent ('the JV company'). There were four directors in the JV company and the applicant and Olio each had two nominees on the Board. Under the JVA, the applicant supplied equipment to the JV company which, in turn, was supplied or rented to Olio to be utilised in Petronas-related projects in Malaysia. The applicant filed the present application under s. 348 of the Companies Act 2016 ('the CA') to obtain leave of the court to commence a derivative action for and on behalf of the JV company to recover sums due on unpaid invoices from Olio. According to the applicant, (i) the JV company was owed money by Olio but the JV company had not taken any action to recover the sums owed; (ii) the Managing Director ('the MD') of the JV company was a nominee of the applicant and it would have been quite possible for the MD to have exercised his executive powers to commence a suit for and on behalf of the JV company against Olio; and (iii) the applicant, in an abundance of caution, had commenced an originating summons to obtain leave of the court to commence the derivative action in order to forestall any argument being raised that the JV company lacked *locus* or authority to prosecute the claim. Objecting against the present application, the respondents argued that (i) they did not receive any notice, notifying them that the applicant was applying for leave of the court, pursuant to s. 348(2) of the CA; (ii) the letter signed by the directors nominated by the applicant was not dated and since the letter was attached to an email sent on behalf of the company secretary, the letter was not sent by the applicant but by someone acting for the company secretary of the JV company, in contravention with s. 348(2) of the CA; (iii) the present application was not made in good faith as (a) the court was not seized with the jurisdiction to hear the matter as there existed an arbitration agreement in the terms of the JVA;

A (b) the application was intended to allow the applicant to be paid in preference to all other creditors of the JV company upon its liquidation; and (c) the applicant had been secretly misappropriating profits of the JV company.

Held (allowing application with costs):

B **(1)** The function of the notice under s. 348(2) of the CA was to give an opportunity to the company to consider, respond and accede to a request by a complainant for proceedings to be commenced in the name of the company. As evinced by documentary evidence, the notice had indeed adequately been given to the first and second respondents through the email sent on behalf of the company secretary. (paras 16 & 19)

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(2) The fact that the letter was undated was of no particular consequence. What mattered was the date on which the notice was sent and received. The fact that the letter was sent through the company secretary was immaterial. The company secretary was a mere conduit through whom

D communications were routed, in much the same way that communications routed through common carriers as the postal service did not detract from the fact that, in the eyes of the law, the writer of the communications was the person from whom they emanated. (paras 19 & 20)

E **(3)** The arbitration agreement in the JVA did not apply to the present dispute. The applicant was seeking to obtain leave in order that the JV company initiates a suit against Olio for debts that were contended to be due from Olio to the JV company. The dispute did not concern any rights and obligations accrued between Olio and the applicant in their

F capacity as shareholder in the JV company. The simple fact that the JV company was not party to the JVA meant that the arbitration agreement in the JVA did not bind the JV company and had no application in the present case. (para 26)

(4) The contention that the derivative action would result in the applicant

G being paid in advance to the other creditors of the JV company had not been made out. In the event that the JV company was successful in recovering any debts that might be due from Olio, that money will accrue to the JV company and not to the applicant. If the applicant was a creditor of the JV company and the JV company was wound up, the

H applicant would then simply have taken to claim as an unsecured creditor of the JV company in its liquidation. Its debts would rank *pari passu* with those of the general body of creditors. (para 27)

(5) In relation to the contention of misappropriation of profits of the JV company, the respondents submitted that the applicant had caused the

I JV company to enter agreements to rent equipment from a company known as Drill Stem Middle East LLC ('Drill Stem'). This arrangement was carried out without the approval of the Board of Directors of the JV

company. These allegations did not, in any way, relate to the amounts said to be owed by Olio to the JV company which formed the basis for the application for leave to commence the derivate action. (paras 28 & 30)

(6) The fact that the internal accounting and record-keeping affairs of the JV company had not been completed was no bar for a claim to be commenced against Olio. Indeed, it would be for the court to determine what actually and truly was owed. The putative claim was not wholly devoid of merit and it would be in the best interest of the JV company for the debt to be pursued against Olio. (paras 33 & 35)

(7) There was nothing to prevent the applicant from seeking leave of the court to commence a derivative action in the circumstances of this case. It would be entirely proper for the applicant to anticipate any potential defence that Olio might raise in the subsequent action. On the contrary, the argument raised on behalf of the respondents was disingenuous. If indeed the Olio-nominated directors would not have resisted any proposal to commence a recovery action against Olio, then why have they opposed the application. (paras 37 & 38)

Case(s) referred to:
Celcom (Malaysia) Bhd v. Mohd Shuaib Ishak [2010] 7 CLJ 808 CA ***(refd)***
Fong Wai Lyn Carolyn v. Airtrust (Singapore) Ltd [2011] 3 SLR 980 ***(refd)***
Foss v. Harbottle (1843) 2 Hare 461 ***(refd)***
Richardson Greenshields of Canada Ltd v. Kalmacoff [1995] 22 Or (3d) 577 ***(refd)***

Legislation referred to:
Companies Act 1965 (since repealed), ss. 181A, 181B, 181C, 181D, 181E
Companies Act 2016, ss. 345, 347(1), 348(2), (4), 590

For the applicant - Saranjit Singh & Dhiya Shukri; M/s Saranjit Singh
For the respondents - Shahabudin Shaik Alaudin & Rosnida Che Ibrahim; M/s Shahabudin & Rozima

Reported by Najib Tamby

JUDGMENT

Azizul Azmi Adnan J:

[1] The applicant in this case, Independent Oil Tools Limited (a company incorporated in the United Arab Emirates) made an application under s. 348 of the Companies Act 2016 to obtain leave of court to commence a derivative action for and on behalf of the third respondent, Independent Oil Tools Malaysia Sdn Bhd (the "JV company"), to recover sums due on unpaid invoices from a company known as Olio Resources Sdn Bhd ("Olio"). Olio is the majority shareholder in the JV company.

[2] I allowed the application.

A **Background Facts**

[3] The applicant holds 30% of the issued shares in the JV company, with the remaining shares being held by Olio. The rights and obligations between the applicant and Olio *qua* shareholders are governed by a joint venture agreement dated 27 November 2012. There are four directors in the JV
B company. Each of the applicant and Olio has two nominees to the Board.

[4] The applicant supplies equipment for use in the oil and gas industry.

[5] Under the commercial terms of the joint venture between the parties, the applicant supplied equipment to the JV company, which equipment was then
C supplied or rented to Olio, to be utilised in Petronas-related projects in Malaysia.

[6] The applicant contended that the JV company was owed money by Olio under invoices issued by the JV company to Olio. The JV company, however, has not taken any action to recover the sums owed. The managing director of the JV company is a nominee of the applicant, and therefore it
D would have been quite possible for the managing director to have exercised his executive powers to commence a suit for and on behalf of the JV company against Olio. Nonetheless, the applicant has, in an abundance of caution, commenced the originating summons to obtain leave of court to commence the derivative action. This, according to Mr Saranjit for the
E applicant, was to forestall any argument being raised in the subsequent writ action that the JV company lacked *locus* or authority to prosecute its claim.

The Requirements Under The Companies Act 2016

[7] Prior to 2007, there was no statutory right to commence a derivative
F action on behalf of a company. Aggrieved, parties had therefore to rely on the common law in order to commence an action to seek redress for a wrong done to a company or to recover debts or damages that were claimed to be due to a company. A putative plaintiff had to show that it came within one of the accepted exceptions to the "proper plaintiff" rule in *Foss v. Harbottle*[1].

G **[8]** The Companies (Amendment) Act 2007 introduced many new provisions, chief among which were substantial (and much needed) modifications to directors' duties. A new s. 181A was also introduced, which created a statutory right to commence a derivative action. The common law right was however preserved.

H **[9]** The recently introduced Companies Act 2016 maintains the substance of the previous ss. 181A to 181E of the Companies Act 1965, with one critical difference: the common law right to commence or defend a derivative action has now been abrogated.

[10] The right to initiate, intervene in, or to defend a proceeding on behalf
I of a company is granted (and granted exclusively) under s. 347 to a "complainant". Section 345 defines a complainant to include a member of a company, a person who is entitled to be registered as a member of a company, a former member of a company (if the application relates to the

circumstances in which the person ceased to be a member), a director of a company and the Chief Executive Officer of the Companies Commission of Malaysia in the case of companies whose affairs are under investigation under s. 590.

[11] Leave of court must first be obtained before a derivative action may be commenced. The proceedings that were before this court were to obtain the leave that was required under s. 347(1) of the Companies Act 2016. Under s. 348(2), the complainant must give 30 days' notice in writing to the directors of his intention to apply for leave of court. Once leave has been obtained, the complainant has 30 days from the date on which leave was granted to commence the proceedings in the name of the company.

[12] In exercising its discretion whether or not to grant leave to the complainant to commence a derivative action, the court must consider whether the complainant is acting in good faith and whether it appears *prima facie* to be in the best interest of the company that the application for leave be granted: s. 348(4).

Is The Applicant A "Complainant"?

[13] The applicant in this action, Independent Oil Tools Limited, is a shareholder in the JV company. As such, it is a "complainant" within the meaning of s. 345 of the Companies Act 2016.

The Requirement For Notice

[14] The applicant exhibited a letter[2] signed by its nominee directors giving notice pursuant to s. 348(2). This letter was given to the company secretary of the JV company. The company secretary then forwarded this letter *via* email to the other directors of the JV company, namely the first and second respondents here.

[15] The respondents raised a number of reasons as to why this notice was defective:

(a) the first and second respondents denied having received the notice issued through the company secretary;

(b) the letter signed by the directors nominated by the applicant was not dated; and

(c) because the letter was attached to an email sent on behalf of the company secretary purportedly to the first and second respondents, the letter in fact was not sent by the applicant but rather by someone acting for the company secretary of the JV company. This, it was submitted, was in contravention of s. 348(2), which requires the notice to be sent by the complainant itself.

[16] The function of the notice provision is to give an opportunity to the company to consider, respond and accede to a request by a complainant for proceedings to be commenced in the name of the company. Thus, if a notice

is sent to a company, and the company then responds by stating that it has taken note of the contents of the letter in which the notice is comprised, and will be commencing legal action in the manner suggested or requested, there would be no further need for the complainant in such a case to proceed to make the application to obtain leave of court pursuant to s. 348.

[17] Even if it is contended that the notice had not been duly given, the company would nonetheless become aware of the proposal for a derivative action to be commenced when it is served with the cause papers for the application under s. 348. The company would then be able to consider the facts underlying the application and it would be open to the company after due consideration to either agree to commence the litigation action (in which case the application would be withdrawn), or to agree to the application itself (in which case the application would be approved by the court on the basis that it is unopposed).

[18] Here, the respondents have taken the course of opposing the application. From the time the cause papers were served on the JV company on 1 August 2017 and the date of the hearing on 9 October 2017, the respondents would have had ample opportunity to consider the reasons put forth by the applicant to support the application for derivative action. They could have acceded to the request to commence the litigation action against Olio, in which case the application would have been wholly unnecessary, and they would have been entitled to costs if the court was of the view that the requirements for notice had not been strictly complied with. Having instead opposed the application, it would not lie in their mouths to then state that there has been inadequate notice. That particular horse, in my respectful view, has long since bolted.

[19] Even if it were contended that the notice requirement must be strictly complied with in all cases, I am satisfied that there had been adequate written notice given, as evidenced by the documentary trail in exh. AE5. The averment contained in para. 25 of the respondents' affidavit in reply in encl. 7 is, in my view, nothing more than a bare denial. I was satisfied that, on balance, the notice had indeed been given to the first and second respondents through the email sent on behalf of the company secretary. That the letter itself was undated is of no particular consequence, as what matters is the date on which the notice was sent and received.

[20] I am also of the view that the fact the letter was sent through the company secretary was immaterial. The company secretary was a mere conduit through whom communications were routed, in much the same way that communications routed through common carriers such as the postal service do not detract from the fact that in the eyes of the law, the writer of the communications is the person from whom they emanate.

The Requirement Of Good Faith

[21] The Court of Appeal in the case of *Celcom (Malaysia) Bhd v. Mohd Shuaib Ishak*[3] explained the requirement of good faith in connection with an application for leave to commence a derivative action in the following terms:

> The second crucial requirement for the determination of the court in granting leave is the need for the respondent to show that he was acting in good faith in making this application (s. 181B(4)(a)). The onus of proof here is on the respondent on a balance of probabilities. The test of good faith is two-fold. One is an honest belief on the part of the respondent, and two, that this application is not brought up for a collateral purpose.

[22] The affidavits affirmed on behalf of the applicant, not unexpectedly, put forth the contention that the application had been made in good faith. Nonetheless, the honest belief on the part of the applicant is not by itself sufficient. The application must also not be one that is made for a collateral purpose. Of course, the bringing of the suit may also ultimately be in the interests of the applicant, but the simple fact that the interests of the applicant is congruent with the interests of JV company does not prevent it from seeking and obtaining leave to commence a derivative action: See, for example, *Richardson Greenshields of Canada Ltd v. Kalmacoff*[4].

[23] The respondents put forward three reasons why I ought to find that the application was not made in good faith:

(a) the court was not seised with the jurisdiction to hear the matter, as there existed an arbitration agreement in the terms of the joint venture agreement between Olio and the applicant; and

(b) the application was intended to allow the applicant to be paid in preference to all other creditors of the JV company upon its liquidation; and

(c) the applicant has secretly been misappropriating profits of the JV company.

[24] I deal with each of these contentions in turn.

[25] The joint venture agreement was entered into between Olio and the applicant for the purposes of establishing the JV company and to regulate their rights *inter se* in their capacity as shareholders. The JV company was not a party to the joint venture agreement.

[26] In my view, the arbitration agreement contained in the joint venture agreement does not apply to the present dispute. Here, the applicant was seeking to obtain leave in order that the JV company initiates a suit against Olio for debts that were contended to be due from Olio to the JV company. The dispute does not concern any rights and obligations accrued between Olio and the applicant in their capacity as shareholders in the JV company. Indeed, the simple fact that the JV company is not a party to the joint venture agreement means that the arbitration agreement in cl. 15 of the joint venture agreement does not bind the JV company and has no application in the present case.

[27] The contention that the derivative action will result in the applicant being paid in advance to the other creditors of the JV company has not been made out. In the event that the JV company is successful in recovering any debts that may be due from Olio, that money will accrue to the JV company, and not to the applicant. If the applicant is a creditor of the JV company and the JV company is wound up, then the applicant will simply have to claim as an unsecured creditor of the JV company in its liquidation. Its debts would rank *pari passu* with those of the general body of creditors.

[28] In relation to the contention of misappropriation of profits of the JV company, it was advanced for the respondents that applicant had caused the JV company to enter into agreements to rent equipment from a company known as Drill Stem Middle East LLC ("Drill Stem"). These equipment were then supplied to various customers. It was contended that this arrangement was carried out without the approval of the Board of Directors of the JV company. The arrangement came to light when Drill Stem sued the JV company for overdue rental payments. Eventually, the dispute was settled by the payment of USD800,000 by the JV company to Drill Stem.

[29] In the Singapore case of *Fong Wai Lyn Carolyn v. Airtrust (Singapore) Ltd*[5], the plaintiff Ms Fong, who was a Director of Airtrust (Singapore) Ltd, sought leave of court to commence an action against Ms Kao, the managing director of the company, for breach of fiduciary duties. It was contended that Ms Kao had diverted business opportunities away from the company and had also entered into agreements and transactions in which she or her relatives had interests. It was advanced on behalf of Ms Kao that Ms Fong had herself been guilty of breaches of fiduciary duty by letting her father, who had founded the company, run it with Ms Kao. After setting out the basic facts relating to these contentions, Judith Prakash J held:

> 75. However, even if I accepted that both of the above arguments had some evidential basis, I did not see how Ms Fong's conduct was relevant to the inquiry of good faith. This was because the law indicates that only conduct that related to the commencement of the derivative application would be relevant to substantiate any alleged lack of good faith. *Woon's Corporations Law* at para 603 pointed out:
>
> > Note that the good faith needed under s. 216A(3)(b) is good faith with respect to commencing the derivative action, not good faith generally in all past conduct of the applicant …

[30] Returning to the present case, the allegations relating to Drill Stem, whatever their merits might be, do not in any way relate to the amounts said to be owed by Olio to the JV company, which formed the basis for the application for leave to commence the derivative action. As such, I was unable to agree with learned counsel for the respondents that the lack of good faith (if any) on the part of the applicant relating to the Drill Stem incident precluded its application here.

Whether The Action Was *Prima Facie* In The Interests Of The Company

[31] The final requirement to be fulfilled in connection with an application for leave to commence a derivative action is that the applicant must satisfy the court that the action is *prima facie* in the best interest of the company. It is sometimes said that the applicant has the additional burden of showing that he has a reasonable basis for his complaint. I am of the respectful view that these requirements are one and the same: if it cannot be shown that the action has some semblance of merit, then it would follow that pursuing the action would not be in the best interest of the company.

[32] In the present case, the applicant contended that Olio owed the JV company an amount in excess of USD1 million. The respondents did not dispute that there existed debts due from Olio to the JV company, but argued instead that:

(a) the final amount owed by Olio to the JV company had yet to be ascertained, due to an ongoing reconciliation exercise in respect of the accounts of the JV company; and

(b) Olio was owed commissions by the applicant.

[33] In my judgment, the fact that the internal accounting and record-keeping affairs of the JV company had not yet been completed was no bar for a claim to be commenced against Olio. Indeed, it would be for the court to determine what actually and truly was owed.

[34] On the issue of the commissions owed by the applicant to Olio, such commissions would have no bearing on the debts due from Olio to the JV company. Such commissions were not owed by the JV company, and hence there was no question of any set-off arising.

[35] I was therefore satisfied that the putative claim was not wholly devoid of merit and that it would be in the best interests of the JV company for the debt to be pursued against Olio.

Whether The Application May Validly Be Made In An Abundance Of Caution

[36] It was advanced for the respondents that the Managing Director of the JV company (whom it will be recalled is a nominee of the applicant) was already vested with wide powers of management, and that accordingly the managing director could proceed to commence legal action against Olio without the need to either obtain Board approval or to make an application for leave of court to commence a derivative action. It was further argued that the applicant's position that the application was made "in an abundance of caution" did not constitute good grounds to support an application under s. 348 of the Companies Act 2016. There was no evidence – according to the respondents – that the directors nominated by Olio would oppose the decision to file an action against Olio. For these reasons, learned counsel urged the court that the application ought to be dismissed *in limine*.

[37] I am of the view that there was nothing to prevent the applicant from seeking leave of court to commence a derivative action in the circumstances of this case. It would be entirely proper for the applicant to anticipate any potential defence that Olio may raise in the subsequent action.

[38] On the contrary, I was of the view that the argument raised on behalf of the respondents to be disingenuous. If indeed the Olio-nominated directors (being the first and second respondents here) would not have resisted any proposal to commence a recovery action against Olio, then why have they opposed the application?

[39] There also remains a possibility that the argument put forth on behalf of the first and second respondents that the managing director has the requisite authority to commence the action against Olio would give rise an estoppel that would prevent Olio from raising any objection on any lack of authority in the subsequent proceedings. However, I see no necessity for me to rule on this point.

[40] For the reasons explained, the application was allowed with costs.

Endnotes:

1. (1843) 2 Hare 461.
2. Exhibit AE5 in encl. 4.
3. [2010] 7 CLJ 808; [2011] 3 MLJ 636.
4. (1995) 22 Or (3d) 577 (Ont CA).
5. [2011] 3 SLR 980.